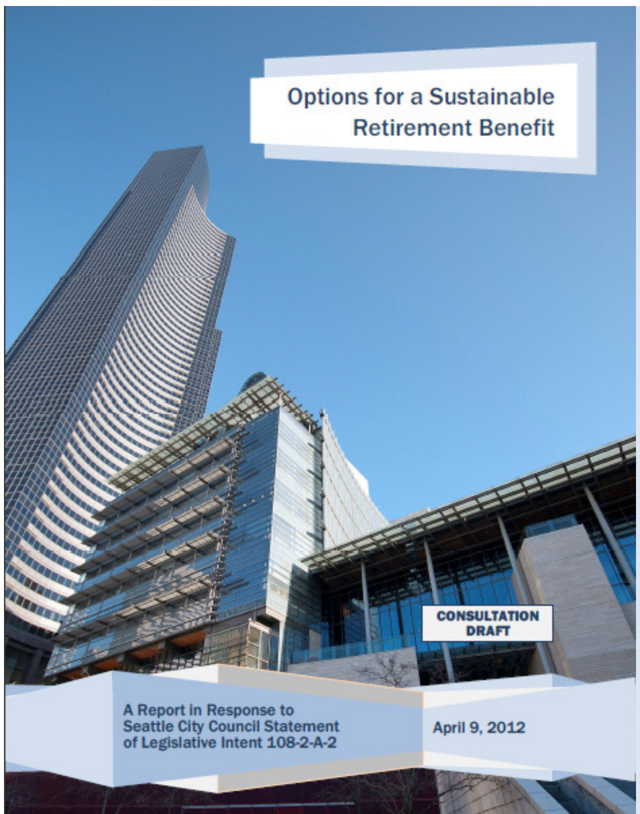
City of Seattle Retirement IDT



PRESENTATION TO THE
CITY COUNCIL

April 9, 2012

Council Mandate

- Statement of Legislative Intent (SLI) 108-2-A-2 directed staff to research alternative pension designs for new hires and report back in early 2012.
- The goal was to find benefit designs that provide adequate retirement income to City employees, in conjunction with Social Security, at a lower cost to both employees and the City.
- Council appropriated $250,000 for consulting resources to support that effort. The Legislative Department hired national actuarial firm Gabriel, Roeder, Smith & Co. (GRS) to guide the research and perform cost estimates.
- The Retirement Interdepartmental Team (IDT) met throughout 2011 and 2012, with representation from Law, CBO, FAS, Council Staff, and the Retirement Office. The team's "Consultation Draft" report is now ready for stakeholder review.

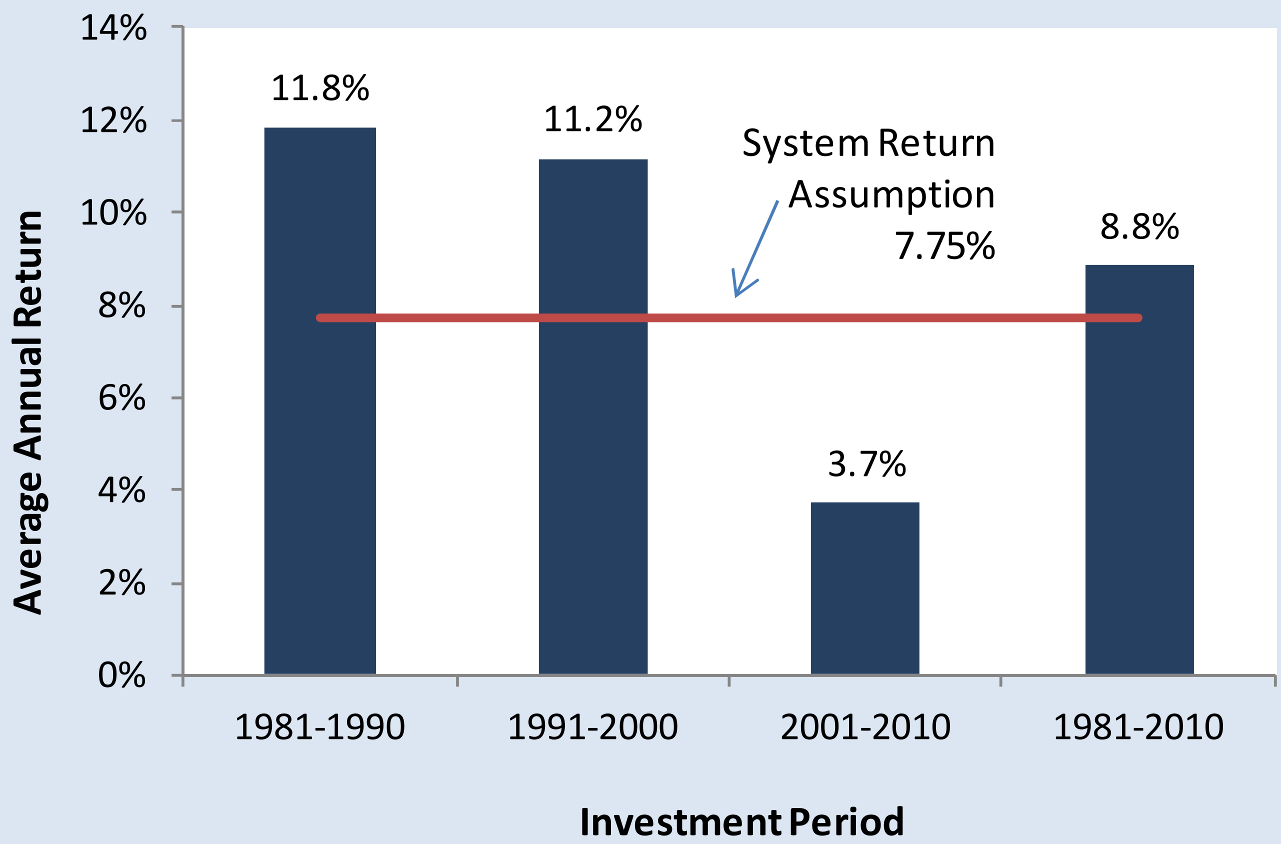
SCERS Facts

- The Seattle City Employees' Retirement System (SCERS) is a defined benefit pension plan for most general government and utility employees. The plan has 10,597 active or vested members plus 5,428 retirees and other beneficiaries.
- The average pension payment is about $22,800 per year. The pension is designed to work in conjunction with Social Security.
- Under the current benefit, members earn 2% of salary in retirement for each year of City service, and are vested after 5 years. For example, 30-year employees can receive a lifetime pension worth 60% of salary.
- The plan is supported by employee and City contributions into the Retirement Fund each pay period, plus earnings on a $1.8 billion investment portfolio. The plan is governed by a seven-member Board of Administration, which includes representation from City leaders and employees.

The Current Problem

- In any pre-funded retirement plan, investment earnings provide most of the funds needed to pay benefits.
- SCERS currently faces about $1 billion in unfunded pension liabilities. This is due primarily to:
  - Investment losses in 2008 that reduced the system's funded status by almost one third.
  - Increasing employee life spans, which raise the total cost of the lifetime guaranteed benefit.
- It is unlikely that even strong investment returns will make up this lost ground without substantially higher pension contributions.

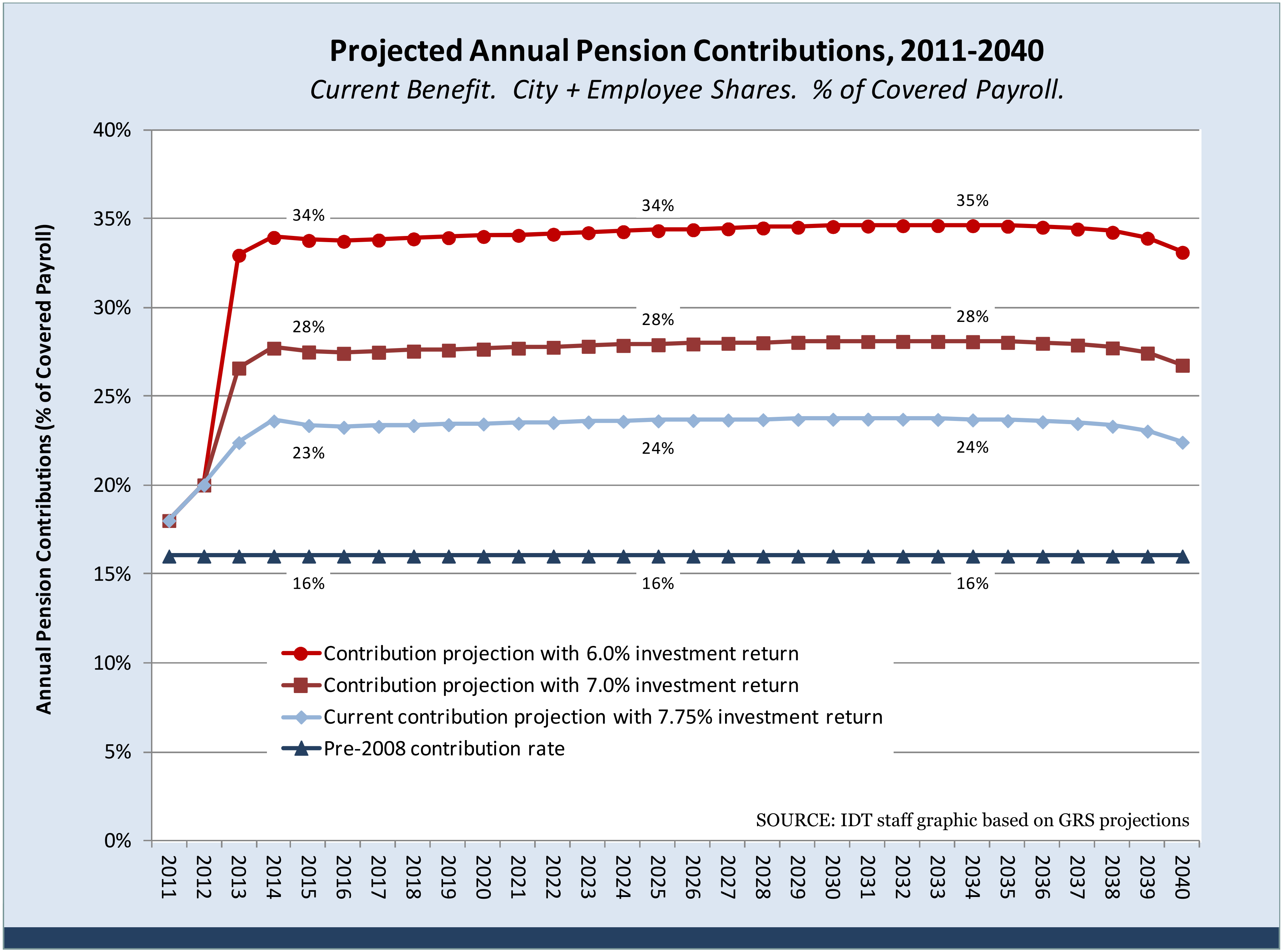
SCERS Recent Investment Returns



SOURCE: IDT staff calculation based on SCERS records

The Future Risk

- It is unclear whether pension funds can expect a 7.75% return in the future.
- Recent history has had a sobering effect on expectations.
  - All major investment firms surveyed have lowered their capital markets assumptions, typically for a 10-year timeframe.
  - SCERS' investment consultants are currently projecting a 7.0% return on the current portfolio.
- Demographic trends may portend weaker returns for developed nations like the United States.
- Developing economies are likely to generate the strongest returns. Indeed, the SCERS Board is looking at an allocation to "emerging market" stocks, which may include Mexico, India, and China.


Projected Annual Pension Contributions, 2011-2040
Current Benefit. City + Employee Shares. % of Covered Payroll.
Annual Pension Contributions (% of Covered Payroll)
40%
35%
30%
25%
20%
15%
10%
5%
0%
34%
34%
35%
28%
28%
28%
23%
24%
24%
16%
16%
16%
Contribution projection with 6.0% investment return
Contribution projection with 7.0% investment return
Current contribution projection with 7.75% investment return
Pre-2008 contribution rate
SOURCE: IDT staff graphic based on GRS projections
2011
2012
2013
2014
2015
2016
2017
2018
2019
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2026
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2040

Options to Reduce Pension Costs

- The team, working with GRS, designed 5 potential retirement plans for new hires, with lower costs than the current design. The plans would reduce required contributions by between 2% and 5% of covered payroll.

- GRS estimated that the plans would lower pension costs between $1.1 and $2.8 billion over the next 30 years. The savings would accrue gradually as new hires enter the system.

- While contribution rates are subject to negotiation, the plans as modeled by the IDT did feature lower contributions for both new-hire employees and for the City.

- All 5 plans are designed to provide a retirement income, in conjunction with Social Security, that's adequate to maintain the employees' standard of living. Retirement planners typically recommend replacing 80% or more of your working income.

IDT Research Findings

- Private sector employers since about 1978 have largely abandoned defined benefit pensions in favor of "defined contribution plans," like the 401(k). These feature an investment account funded by employee contributions, typically with an employer match worth 3% to 6% of salary, but no benefit guarantee.

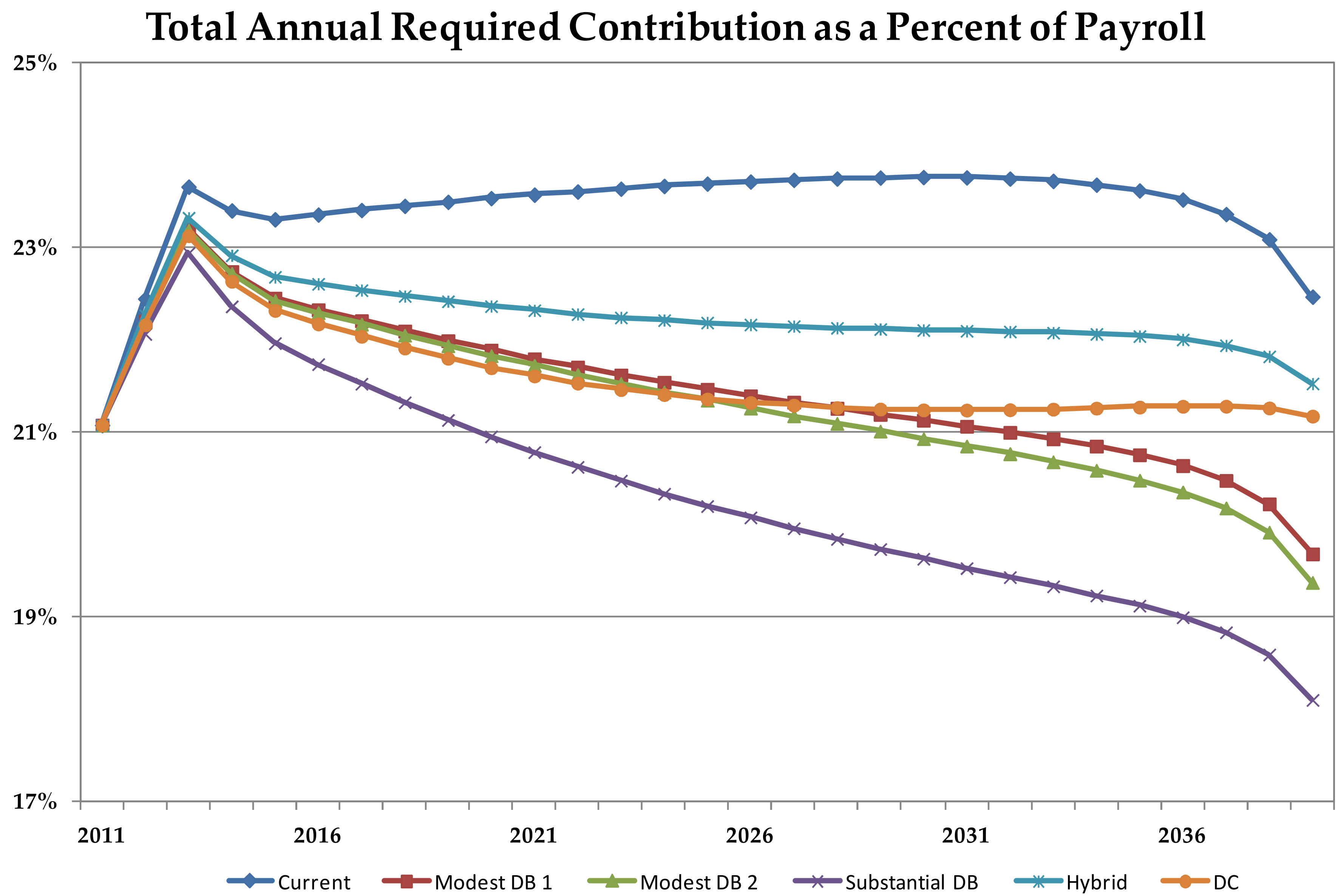
- Public sector employers generally still provide defined benefit plans. Seattle's current plan is in the high-cost, high-benefit end of the spectrum.* In particular, the current benefit:

  - Provides 2% of salary for each year of City service. The average public plan provides 1.85%.
  - Allows for full, unreduced retirement while employees are in their 50s in many cases. Most other public plans have moved to age 60 or 65 as the "normal" retirement age.
  - Subsidizes early retirement somewhat by applying relatively modest reduction factors when an employee retires younger than the normal retirement age.
  - Also charges Seattle employees about twice as much (10.03% of salary vs. about 5%) for their pension benefit as the average public employee.

* All comparisons from The Public Fund Survey data on 126 state and local plans.

5 Retirement Options

- 3 of the new designs keep the current defined benefit (DB) structure intact, but offer a different deal to new hires. This would create a “Tier 2” within the SCERS plan, as Spokane did in 2009.
  - The plans feature a combination of higher retirement ages, a lower multiplier for each year of service, and steeper reductions for early retirement, among other changes.
  - One of the plan designs is quite similar to the PERS 2 plan offered by the State of Washington to State and local employees.
- 1 plan is a defined contribution (DC) approach, with employer and employee contributions into an individual investment account.
- 1 plan is a hybrid of the DB and DC approaches. It features a half-size DB pension coupled with an individual investment account funded by employee contributions.
  - This plan is fairly similar to the State of Washington’s PERS 3 plan, and similar in structure to the FERS plan for federal employees.



SOURCE: GRS Analysis

Implementation Options

- Instead of creating our own new plan, Seattle could choose to approach the Legislature about joining the State's open PERS 2 and PERS 3 plans.
  - This move may allow higher investment returns through the Washington State Investment Board. It may also lower administrative costs.
  - Joining the state would entail a certain loss of control over contribution rates. Also, the issue of Plan 1's unfunded liability would need to be addressed.
- The City may also choose offer current employees the chance to opt into the new plan in exchange for a lower contribution rate that new hires pay. Employees would keep the service credit earned to date, but would earn future credit under the new plan's rules.
  - Voluntary switches would accelerate the savings to employees and the City.
  - GRS projects a low take-up rate on this offer.

Process From Here

- The report is a "consultation draft," intended to begin conversations with stakeholders. Its results may inform labor negotiations and potential legislation in 2012-2013.
- The IDT will conduct a series of briefings on the report options, including:
  - SCERS Board of Administration (April 12)
  - Council's Government Performance & Finance Committee (April 18)
  - Employee groups (e.g. labor unions, ARSCE retiree group, tbd)
  - Others, per request
- The GP&F Committee has a web page set up with report materials and briefing schedules. http://www.seattle.gov/council/issues/retirement_system.htm
- The IDT welcomes feedback on this draft. The e-mail address for this is retirementidt@seattle.gov